

Assembly Bill 155 (Dababneh)

Date: Introduced

Program: Sales and Use Tax

Sponsor: Author

Code: Revenue and Taxation Code Sections 6359, 6359.2, 6359.4, and 6359.45

Effective: Upon enactment, but operative January 1, 2016

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**Summary:** Exempts from the sales and use tax certain food products sold through vending machines.

**Purpose:** Equalize the tax treatment of cold food products, such as candy, crackers, and chewing gum, which are exempt from tax if purchased from a grocery store, but partially taxed if sold through a vending machine.

**Fiscal Impact Summary:** Annual state and local revenue loss of \$5 million.

**Existing Law:** Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law<sup>1</sup> imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state or the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. Current law<sup>2</sup> provides a general exemption for sales of food products for human consumption. However, this food exemption does not apply to certain sales of food and beverages,<sup>3</sup> such as:

- Food and beverages sold for consumption at a retailer's place of business (such as restaurants, bakeries, hotels, or food courts).
- Food and beverages sold for consumption in places where admission is charged (such as movie theaters, amusement parks, music or sporting events, county fairs, swap meets and trade shows).
- Food products sold as hot prepared food products (such as hot sandwiches, hot soup or pizza).
- Food products sold through a vending machine.<sup>4</sup>

Regarding vending machines, current law provides that 33% of the gross receipts from the retail sale of food products are subject to tax when sold through a vending machine. Food products include cold food products, hot coffee, hot tea, and hot chocolate, when those food products are actually sold through a vending machine. Food products do not include other hot prepared food products defined in Section 6359, such as a hot meal, a hot sandwich, or a hot pizza. The term "food products" does not include carbonated beverages.

In addition, current law<sup>5</sup> contains legislative findings that 33% percent represents the statewide average of taxable food products sold through vending machines. The Legislature established this average to simplify tax auditing procedures and provide uniformity in the taxation of gross receipts derived from vending machine food sales.

**Proposed Law:** This bill repeals and adds RTC Section 6359.2 to exempt from the sales and use tax "food products" sold through a vending machine. The bill defines food products to include cold food products and hot coffee, hot tea, and hot chocolate, when those hot beverages are actually sold through a vending machine for a separate price. Food products do not include other hot prepared food products

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<sup>1</sup> Part 1, Division 2 of the Revenue and Taxation Code (RTC) (commencing with Section 6001).

<sup>2</sup> RTC Section 6359 of the Sales and Use Tax Law.

<sup>3</sup> RTC Section 6359(d)

<sup>4</sup> RTC Section 6359.2; and California Code of Regulations, title 18, Regulation 1574, subdivision (b)(2)

<sup>5</sup> RTC Section 6359.2(d).

defined in Section 6359 (e.g., hot sandwiches, pizza, barbecued chicken, soup, steak, and so forth). The bill also makes conforming changes to Sections 6359, 6359.4, and 6359.45.

As a tax levy, the bill is effective immediately, but becomes operative on January 1, 2016.

**Background:** Grocery store sales of cold food products and individual hot drinks to go are generally exempt from sales tax. Tax does not apply when a grocery store sells candy, chips, fruit juice, and hot coffee to go. However, vending machine sales of those same items are partially taxable. Tax applies to 33% of the retailer's gross receipts from vending machine sales of cold food products (including noncarbonated water), hot coffee, hot tea, and hot chocolate. Vending machine sales of all carbonated beverages and hot food products (other than hot beverages) are fully taxable, just as when sold in a store or at a restaurant.

Since the retailer is unable to determine whether food sold was consumed on or off the premises where the vending machine is located, a standard approximation of food consumed at the vending machine site was established in law. Accordingly, to simplify the vending machine operators' reporting requirements, Section 6359.2 was added to provide that 33% represents taxable sales of cold food products, hot coffee, hot tea, and hot chocolate consumed at a retailer's facilities; the remaining 67% is exempt.

In 1983, Section 6359.2 was repealed, making taxable 100% of a retailer's vending machine gross receipts.

In 1988, Section 6359.2 was again added to law to provide a partial exemption for cold food products sold through vending machines. Due to revenue considerations, the exemption was phased in during 1988 and 1989. In 1988, 77% of vending machine food products sales were subject to tax. Beginning 1989, 55% were subject to tax, and in 1990 and thereafter, the current 33% taxable rate was established.

Five other vending machine sales bills were considered during the 1999-00, 2001-02, and 2007-08 Legislative sessions: AB 890 (Floyd, 1999), AB 2824 (Cardoza, 2000), AB 893 (Campbell, 2001), AB 1427 (Nation, 2001), and AB 728 (Plescia, 2007) would have exempted from the sales and use tax, packaged candy, gum and confectionery, snack foods, and bottled water sold through a vending machine. "Snack foods" was defined as cookies, crackers, chips, snack cakes and pies, pastries, pretzels, granola snacks, popcorn, fabricated chips and snacks, trail mix, nuts, edible seeds, dried fruit snacks, meat snacks, and snack mixtures. AB 890, AB 1427, and AB 728 were held in the Assembly Appropriations Committee. AB 2824 and AB 893 were held in the Assembly Revenue and Taxation Committee.

AB 155 (Dababneh) differs in that, in addition to candy, gum and confectionery, snack foods, and bottled water, it also exempts all cold food products (e.g., apples, tuna sandwiches, or hard-boiled eggs) and hot beverages (hot coffee, hot chocolate, hot tea).

### Commentary:

- 1. Effect of the bill.** This bill creates a full sales tax exemption for cold food products (including bottled water), hot coffee, hot tea, and hot chocolate sold through vending machines.
- 2. Sales of carbonated beverages and hot food products would still be taxable.** Under current law, sales of all carbonated beverages and hot food products (other than hot beverages) sold through vending machines are 100% taxable, which is consistent with sales made by other retailers. This bill would not change the application of tax to these products sold through vending machines.
- 3. Suggested technical amendment.** Proposed subdivision (c) of Section 6359.45 makes reference to *Section 6359.4*, and states that this section shall not apply to any vending machine operator which is a nonprofit, charitable, or educational organization that is a retailer of tangible personal property that is a food product as defined in "*subdivision (b) of Section 6359.4.*" However, since this bill

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repeals Section 6359.4, “food products” as defined in subdivision (b) of Section 6359 is a more appropriate reference. Accordingly, BOE staff recommends the following amendment:

On page 6, line 20; replace “Section 6359.4” with “Section 6359.2”

**Administrative Costs:** BOE will incur absorbable administrative costs related to notifying affected retailers, addressing potential errors on returns, amending appropriate regulations, and answering inquiries from the general public and affected retailers.

## Revenue Impact:

### Background, Methodology, and Assumptions

According to the U.S. Census Bureau *Economic Census*, national sales of groceries and other food items for human consumption sold through vending machines were \$4.61 billion in 2012. Of these, \$2.36 billion represents sales of carbonated beverages, which would still be subject to tax. Therefore, vending machine sales affected by this bill were estimated at \$2.49 billion in 2012 (\$4.61 billion – \$2.12 billion = \$2.49 billion).

*Economic Census* data from the 2007 Census show that California accounted for 7.2% of U.S. vending machine sales. This implies 2012 California sales of about \$179 million (7.2% of \$2.49 billion). Since 33% of sales are subject to tax under current law, taxable sales affected by this bill were about \$59 million in 2012.

According to *IBIS World*, vending machine sales have been virtually flat since 2010, growing only 0.5% per year from 2010 to 2015. We assumed this growth rate for the Census Bureau data cited above from 2012 to 2017. For fiscal year 2016-17, taxable sales affected by this bill are estimated to be about \$61 million.

### Summary

The annual revenue loss from exempting \$61 million in sales through vending machines from the sales and use tax would be about \$5 million in fiscal year 2016-17, broken out as follows:

	Rate	FY 2016-17 (\$ Thousands)
State General Fund	3.94%	\$2,391
Proposition 30 (Half-year impact) <sup>6</sup>	0.125%	76
Local Revenue 2011	1.06%	645
Local Revenue 1991	0.50%	304
Public Safety Fund	0.50%	304
Bradley Burns	1.25%	759
Special Districts	0.92%	559
Statewide Average Rate	8.3%	\$5,038

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

<sup>6</sup> Proposition 30, which raised the sales and use tax rate by 0.25%, expires on December 31, 2016.

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